

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 06-0148

Sales/Use Tax

For the Period: 1997 through 2004

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ISSUE

I. Sales/Use Tax—Contractor

Authority: IC § 6-8.1-5-1(b); 45 IAC 15-5-3(b); IC § 6-2.5-4-9;
45 IAC 2.2-3-7; 45 IAC 2.2-3-8; 45 IAC 2.2-3-9; 45 IAC 15-11-2

STATEMENT OF FACTS

The taxpayer, a contractor, was audited by the Department of Revenue. The taxpayer protested portions of the audit. An administrative hearing was held on August 22, 2006. This Letter of Findings results from the hearing and the information provided by the taxpayer. More facts will be provided below.

I. Sales/Use Tax—Contractor

DISCUSSION

Before examining the taxpayer's protest, it should be noted that the *taxpayer* bears the burden of proof. IC § 6-8.1-5-1(b) states in pertinent part:

The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.

The Indiana Administrative Code also states "[t]he burden of proving that a proposed assessment is incorrect rests with the taxpayer...." 45 IAC 15-5-3(b).

The audit report notes the following:

During the audit period, the taxpayer entered into contracts with national [] chains for the preparation of vacant mall locations throughout the United States to accommodate the needs of his customers, the new tenants.

This involved much remodeling of the existing structure, both inside and outside in accordance with the architects specifications. New air conditioning systems, walls, carpeting, painting and plumbing were all a requirement.

Turning to the taxpayer's protest, the taxpayer characterizes its business as follows:

[Taxpayer] is a contractor performing build out services for various retail companies throughout the United States. The company performed one job each in 1997 and 1998 in Indiana for [Company X]. Both of these jobs were for the build out of retail space in a mall and as such related entirely to real property construction. All of the work on the job was done by subcontractors, each of whom was issued a purchase order for the entire part of their contract with [taxpayer].

Taxpayer also argues:

The work that both subcontractors performed was related to real property and therefore sales tax was not charged on the invoice that was sent to [taxpayer]. The auditor for the State of Indiana, based solely on the fact that the invoices from the subcontractor broke down an amount for material and labor presumed that these were not contract jobs but were instead time and material jobs. He further assumed, therefore that sales tax should have been charged or use tax paid on the materials that were part of the job.

Taxpayer further states, "This was not a time and material job but instead a contract job. As such, since everything done was attached to real property and therefore not subject to sales tax, no sales tax should have been charged." The taxpayer summarizes its argument as follows: "Again since the job related to real property, [taxpayer] was not liable for use tax and therefore did not remit any use tax to the state of Indiana."

The taxpayer seems to be arguing that tangible personal property incorporated into real property is not subject to sales/use tax in Indiana. The Indiana Code and the Indiana Administrative Code answer this issue.

IC § 6-2.5-4-9 states in pertinent part:

- (a) A person is a retail merchant making a retail transaction when the person sells tangible personal property which:
 - (1) is to be added to a structure or facility by the purchaser; and
 - (2) after its addition to the structure or facility, would become a part of the real estate on which the structure or facility is located.

45 IAC 2.2-3-7, in relevant part, provides a definition of a "contractor":

(a) Contractors. For purposes of this regulation [45 IAC 2.2] “contractor” means any person engaged in converting construction material into realty. The term “contractor” refers to general or prime contractors, subcontractors, and specialty contractors, including but not limited to persons engaged in building, cement work, carpentry, plumbing, heating, electrical work, roofing, wrecking, excavating, plastering, tile and road construction.

(b) Construction material. For purposes of this regulation [45 IAC 2.2], “construction material” means any tangible personal property to be used for incorporation in or improvement of a facility or structure constituting or becoming part of the land on which such facility or structure is situated.

And finally 45 IAC 2.2-3-8 states (*Emphasis added*):

(a) In general, all sales of tangible personal property are taxable, and all sales of real property are not taxable. *The conversion of tangible personal property into realty does not relieve the taxpayer from a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property.*

(b) All construction material purchased by a contractor is taxable either at the time of purchase, or if purchased exempt (or otherwise acquired exempt) upon disposition unless the ultimate recipient could have purchased it exempt.

As is evident from the citations above “tangible personal property” for incorporation into realty is subject to Indiana’s sales/use tax laws.

The taxpayer also argues that any tax owing is owed by the subcontractors, and not the taxpayer. The taxpayer provided “purchase orders” from two subcontractors, but the purchase orders do not provide any additional insight. The taxpayer also concedes, regarding this line of argument, “Both the subcontractors are no longer in business and therefore we cannot obtain proof from them that they paid sales tax on these materials.” Taxpayer contends that “this was not a time and material job but instead a contract job....”

45 IAC 2.2-3-9 is of importance in resolving this next line of argument. As the 45 IAC 2.2-3-9 states in salient part (*Emphasis added*):

(a) A contractor may purchase construction material exempt from the state gross retail tax only if he issues either an exemption certificate or a direct pay certificate to the seller at the time of purchase.

(b) A contractor who purchases construction material exempt from the state gross retail tax or otherwise acquires construction material “tax-free”, is accountable to the Department of Revenue for the state gross retail tax when he disposes of such property.

(c) *A contractor has the burden of proof to establish exempt sale or use when construction material, which was acquired taxfree, is not subject to either the state gross retail or use tax upon disposition.*

(d) Disposition subject to the state gross retail tax. A contractor-retail merchant has the responsibility to collect the state gross retail tax and to remit such tax to the Department of Revenue whenever he disposes of any construction material in the following manner:

(1) *Time and material contract.* He converts the construction material into realty on land he does not own and states separately the cost for the construction material and the cost for the labor and other charges (only the gross proceeds from the sale of the construction materials are subject to tax), or

(2) Construction material sold over-the-counter. Over the counter sales of construction materials will be treated as exempt from the state gross retail tax only if the contractor receives a valid exemption certificate issued by the person for whom the construction is being performed or by the customer who purchases over-the-counter, or a direct pay permit issued by the customer who purchases over-the-counter.

(e) *Disposition subject to the use tax.* With respect to construction materials a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner:

(1) He converts the construction material into realty on land he owns and then sells the improved real estate;

(2) He utilizes the construction material for his own benefit; or

(3) *Lump sum contract.* He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price.

By “contract job” the Department assumes the taxpayer is referring to a “lump sum contract.” As the audit report noted,

[T]he taxpayer engages in contractor (Lump Sum Billings) wherein the Sales Tax was due at the point of purchase. However, no Indiana Sales Tax was paid when the items were purchased from a retail merchant and no Indiana Use Tax was accrued or remitted as required

As this Letter of Finding stated at the outset, the taxpayer bears the burden of proof. The taxpayer has failed to sufficiently develop its argument, and thus is denied. Also, it is not clear if the taxpayer protested the penalty (*See* 45 IAC 15-11-2 regarding the penalty). At any rate, the taxpayer did not sufficiently develop a penalty argument and the Department is unable to grant taxpayer’s request that the penalty be abated.

Regarding the interest, the taxpayer states that it “request[s] that a calculation of the interest charged on the assessment be provided. We cannot replicate the numbers....” The Audit Division is instructed to provide the taxpayer with documentation explaining how the interest was calculated.

FINDING

Taxpayer protest is denied.

DP/JM/DK October 6, 2006